

## FUTURE PERSPECTIVE ON THE EURO AS A GLOBAL CURRENCY

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### Abstract

*Ten years ago, many EU officials celebrated by abolishing their old, national currency, and embraced the sign of a newer emerging Europe- the Euro. Today, just ten years later, the same people are questioning adopting the Euro, scared by the recent crisis in Greece. 2011 will show the actual dimensions of the economic crisis, provided that austerity measures will be strongly felt and the effects of hundreds of billions of dollars pumped into rescuing financial markets will decrease, leaving room for reality. So, almost certainly, 2011 will be the year to lay the foundation of a strong future Euro, or the beginning of a new Europe without Euro.*

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### 1. Introduction

Ten years ago, many EU officials celebrated by abolishing their old, national currency, and embraced the sign of a newer emerging Europe- the Euro. Today, just ten years later, the same people are questioning adopting the Euro, scared by the recent crisis in Greece.

When an EU citizen took out cash from an ATM machine in 2000, there was usually an honored feeling, despite the fact adopting the Euro created large scale price increases in their countries. Today if EU citizen has any money to pull out of an ATM machine, there may be a growing interior sensation of betrayal.

Recent trends looks like the eventual downfall of the Euro could continue, as the ECB (European Central Bank) indicated European banks to face a debt-write-off of 190 Billion Euro in the next few years.

This is devaluing the Euro, and diminishing hopes that a supposed recovery in Europe is indeed the reality, and some experts are claiming the Euro could be heading downwards to the value as a much fragile US Dollar.

Many economists are also estimating the death of the Euro. Risk-takers also see a bonus in profits, as unlucky nations may be forced to switch back to their previous currencies.

Future will shows us if Europeans decide unity is worth a devalued currency, or else saving personal wealth despite that unity.

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## **2. New perspectives of the euro**

From January 1, 2011, Estonia became the 17th EU country to adopt the euro. It is expected that the passing from the Estonian kroon to the euro to take place in good conditions, thanks to early planning and good information campaigns.

For two weeks after the changeover, the Estonian kroon and the euro will circulate in parallel, and then the euro will become the only legal tender. To assist consumers in the period July 1, 2010 to June 20, 2011, traders will display prices in both currencies.

Estonia will join the euro area in the middle of the most severe crisis of the common currency. Unlike many other Euro zone countries, Estonia has almost no debt. The public debt amounts to only 7.2 percent of GDP. This is the lowest level in Europe. Estonian economy has started to grow again after a negative trend during the financial crisis.

High debt of Ireland, Portugal, Greece and Spain are causing concern among European economists who claim that they push the euro to the limit of its power. Some of Europe's top politicians talk about the fact that the crisis could mean the end of the euro and even the European Union. Ireland's economic collapse could be "a threat to global economy" as were Lehman Brothers, AIG and Goldman Sachs in September 2008, warned Peter Tapsell, a member of the British Parliament.

Ireland made headlines in European newspapers by the stubbornness proved when refused to accept the financial aid offered by the EU. The support for over 90 billion euro that Dublin official have finally accepted, has brought harsh criticism from the public.

Portugal is showing signs that they might follow Ireland in the debt crisis. Portugal is facing a scenario where it will leave the euro zone if it fails to meet economic challenges.

Resolving the crisis involves two major steps:

1. EU countries that have a good economic situation should support those which are in crisis and
2. Countries receiving aid from the EU and the International Monetary Fund must persuade their citizens to accept austerity measures.

Additionally, those member countries which are not yet in the euro zone, such as Poland, the origin of the European Commissioner for Budget, have noted the situation and, although their objective is the euro, they expect a common power source and not common problems.

Romanian authorities have announced 2015 as the official target for adopting the euro. Analysts believe however that the current target is too ambitious, and Romania will not pass before 2020.

Economists warn that if we stubbornly adhere before being prepared, the effects will be significantly negative. Romania should join the euro zone in 2015 according to the schedule announced by the Romanian authorities, only that the target switching to the euro is questioned by economic analysts given the economic situation in recent years and future developments.

Moreover, even representatives of the European Commission (EC) pointed out last year that Romania did not meet any of the criteria for joining the euro zone, namely price stability, government budgetary position, exchange rate stability and convergence of long-term interest, at same time, experiencing legislative obstacles.

Within the euro zone, the single currency is a means by which governments, companies and individuals make and collect payments for goods and services. It is also used to store and create wealth for the future as savings and investment. Size, stability and strength of the euro zone economy, the second largest worldwide after the US, contribute to the attractiveness of the single currency outside its borders.

Public and private sectors from third countries receive and use the euro for different purposes, including as exchange and reserve currency. For this reason, at present, the euro is the second most important international currency after the U.S. dollar. The extensive use of the euro in international financial and monetary system demonstrates its importance in the world.

The euro is increasingly used for the issuance of debt securities and debt securities for companies. In late 2006, the euro represented approximately one third of the total international debt market and the U.S. dollar 44%.

World banks provide significant loans denominated in euro worldwide. Euro ranks second among the most traded currencies on foreign exchange markets, being used in about 40% of daily transactions.

The euro is increasingly used for billing and payment in international trade, not only between the euro zone and third countries but also to a lesser extent, between third countries.

Next to the U.S. dollar, the euro is used very much as a major reserve currency for monetary emergencies. In late 2006, more than a quarter of existing foreign currency reserves worldwide was in euro, compared to 18% in 1999. Developing countries are among those which most increased their reserves in euro, from 18% in 1999 to about 30% in 2006.

Several countries manage their currencies by their correlation with the euro currency taken as reference.

The statute of the euro as the world currency, plus the size and economic power of the euro zone, highly determines the international economic organizations such as the IMF and the G8 to consider the euro zone economy as an independent entity. This ensures a stronger global position for the European Union.

To benefit from this powerful position and to contribute effectively to the international financial stability, the euro zone is expressed increasingly more often as a single voice in important economic forums. This is the result of close coordination between Member States of the euro zone and the cooperation between the European Central Bank and the European Commission during international meetings on economic issues.

A number of countries and regions outside the European Union are even more closely linked to the euro. Due to the stability of the monetary system which supports it, the euro currency has become an "anchor" extremely attractive to these

countries, especially those that have special agreements with the EU institutions, such as preferential trade agreements. By reporting currencies to the euro, these countries provide greater security and stability of national economies.

The euro is widely used in countries and regions in the vicinity of the euro zone, as in south-eastern Europe, while other countries - Monaco, San Marino and Vatican City - use the euro as official currency on the basis of specific monetary agreements with the EU, being able to issue own euro in certain quantitative limits.

2011 will show the actual dimensions of the economic crisis, provided that austerity measures will be strongly felt and the effects of hundreds of billions of dollars pumped into rescuing financial markets will decrease, leaving room for reality.

This year inflation increased utility prices and financial speculation will strongly affect consumption, and the economic progress will decrease.

"In 2011 we will learn how global economy will do without being kept alive artificially,"<sup>27</sup> said Robin Bew expert from the consulting group Economist Intelligence Unit (EIU).

According to EIU estimates, this year, due to austerity measures adopted by all countries of the world, global economic growth will slow to 3.6% from 4.4% in 2010. Change will be influenced primarily by lower global trade by 50% compared to 2010, to 5.7%.

In fact, almost all international organizations, from the World Bank to the International Monetary Fund (IMF) and the main international banking groups, have revised their estimates on the global economy in 2011.

In its quarterly report "World Economic Outlook", recently published, IMF forecast growth of the global economy to 4.8% in 2010 and an expansion of 4.2% in 2011.

For developed economies, the risk of a double recession has reduced considerably, while the emerging economies will revert to the former growth rates, and consumers and governments will work to adjust deficits pushed to record levels during the recession.

2011 will be the year of austerity in Europe. Most states, from Germany, France, Great Britain, Spain to Romania and Bulgaria, will feel the impact of measures taken by governments to reduce the huge budget deficits. In these circumstances, economic growth will be shy, affected by reduced consumption and low public investments.

Economists from the EIU estimate that in 2011, the PIIGS group (Greece, Ireland, Spain, Portugal and Italy) will remain "millstones" for Europe, and Brussels will continue to pump billions to save them.

It seems that austerity will freeze Greece and Portugal in recession, while Spain will be saved almost to the limit, which will see a 0.1% economic progress. Ireland, the second country in the euro zone saved from bankruptcy, will increase by 1 percent in 2011.

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<sup>27</sup> <http://www.eiu.com/public/>

According to EIU, Germany will strengthen its role as the epicenter of the euro zone, following to basically decide the path of Europe and the euro.

The fact is that Germans have been and will be interested in maintaining the euro and countries with problems, given that Europe is the most important area for its exports, and German banks have substantial exposure to securities of the EU countries. If countries like Ireland or Greece failed, it would mean that the German banking system could collapse, bringing inconceivable consequences for the German economy.

For Romania, the forecasts are reserved. Given that the European Union is our main trading partner and the economic recovery projected for 2011 is based, at least in the view of authorities on exports, the plans for economic progress of 1.5% seem quite ambitious. All this, under circumstances that the consumption in the EU, according to the EIU, could fall by 1.8% in 2011.

At the beginning of the year, the International Monetary Fund (IMF) announced the revised weights for the four currencies that determine the value of Special Drawing Rights (SDRs).

The decision on the amount of each currency in the SDR basket is the final step of implementing the most recent results of the SDR valuation methods.

Table 2. Percent of the four currencies in the SDR valuation<sup>28</sup>

Wednesday, January 05, 2011				
Currency	Currency amount under Rule O-1	Exchange rate	U.S. dollar equivalent	% change in exchange rate against U.S. dollar from previous calculation
Euro	0.4230	1.32350	0.559841	-1.084
Japanese yen	12.1000	82.13000	0.147327	0.110
Pound sterling	0.1110	1.55940	0.173093	-0.090
U.S. dollar	0.6600	1.00000	<u>0.660000</u>	
1.540261				
U.S.\$1.00 = SDR			0.649241	0.398
SDR1 = US\$			1.54026	

Source: [www.imf.org](http://www.imf.org)

From January 1, 2011, the American dollar will "weigh" therefore 41.9% (vs. 44%), the euro will weight by 37.4% (vs. 34%), the sterling pound will "climb" to 11.3% from 11% and the yen will go down to 9.4% compared to 11%). The change of the DST structure will affect the debt borrowed from the Fund, but to a lesser extent, the differences are not significant.

<sup>28</sup> [www.imf.org](http://www.imf.org)

Given that the problems will continue in Europe, in 2011 all eyes are primarily directed towards the United States of America, the largest economy and largest consumer of the world.

Unfortunately, America will not do very well, despite the print of trillions of dollars to restore economy. U.S. will continue to live under the burden of debt, waiting for a recovery in consumption, which will be shy but, influenced by the reluctance of banks to grant new loans.

As we move towards the second half of 2011, politicians and specialists will likely succeed to put the Fed in an uncomfortable situation, being the decisive factors which enabled the U.S. housing debacle whose consequences will be the syncope of the banking system and the catastrophe of the public debt. Meanwhile, banks much too strong to fail will find themselves again in a difficult situation, because their problematic mortgage portfolios will threaten again, their solvency.

The dollar devaluation policy, rooted in the war of coins in 2010, will force emerging markets to use more of their dollar reserves on bonds. In addition, the U.S. is on the brink of "japanizing" its economy, with background inflation on a downward trend. The quantitative relaxation proposed by the Federal Reserve has no positive effect, but relieving the pain of U.S. banks' balance. And do not forget the euro zone, where ECB, IMF and EU fail to heal PIIGS peripheral countries, pushing the anxious investors towards the Uncle Sam's safe paradise. It may be that the "feel-good" factor was growing in the U.S. in late 2010, but disappeared in 2011 and the return on bonds over 30 years will fall to 3%.

The war of coins returns in 2011, fueled by the improving economic situation of the U.S. rather by the need to support economic recovery. The U.S. trade deficit is expanding as the government and citizens' wallet empties. Since the trade deficit grows, President Obama's plan to double exports in five years is increasingly becoming an unrealistic goal that urges ordinary citizen to force the American Congress to opt for a weaker dollar. Pressure builds up in China and, while investors flee to metal in search of some stability, gold rises strongly to 1,800 dollars per ounce.

According to analyst estimates, 2011 will confirm the spectacular progress of emerging powers like China, India or Brazil. American and European investors will be thus attracted by opportunities in Asian countries, Latin America and even Africa.

China's spectacular economic progress will continue, following to record, according to Economist Intelligence Unit, a GDP growth of 8.4%, amid the advance consumption by 22%.

The trajectory of growth in most regions of the world seems healthy for a certain period of time in 2011 - at least outside Europe and Japan. But then the problems start to emerge in China, where the 12 new plan for the next five years, aimed at generating increased consumption, will not work as desired. Given that the Chinese industrial base will grow at a rate very low rate or at all following the change of policies, satellite countries that depend on Chinese demand will see their economies facing severe corrections. This will panic global appetite, and given that

Japan's economy makes great efforts and the euro zone is in disarray, the U.S. dollar will no longer look quite so bad as before. This has been the situation since the market was on short position related to this currency at the beginning of the year. The unfolding of these positions pushes the USD index above 25% to over 100 by the end of the third quarter.

Economist Nouriel Roubini expects the Beijing government to continue to support their exporters by keeping the yuan at a devalued rate, example to be followed by other emerging countries, like South Korea or India<sup>29</sup>.

The inflation specter threatens China as well. Consumer price index in November 2010 rose by 5.1% per year, an increase of 4.4% in October, according to data published by the National Bureau of Statistics (NBS). In the first eleven months of 2010, the growth was 3.2%, exceeding the 3% limit set by the government. For 2011, China will set an inflation objective of 4%.

China's monetary policy will be more restrictive in 2011. In November, Chinese banks granted loans worth 64 billion euro. The total value of loans in January rose to 841 billion euro, with a threshold set by the government to 848 billion in 2010. To curb this trend, the People's Bank of China (POBC) has already increased by six times the rate of mandatory bank reserves.

Real estate prices continue to grow. The abundance of liquidity in circulation will induce the Chinese to seek investments, especially in real estate. Since April, the government has taken measures for curbing real estate investments, restricting or forbidding loans to buy a third house. However, the real estate bubble continues to swell. A report published in early December by the Academy of Social Sciences showed that one third of the big cities offered apartments with 30% -50% more expensive than their real value. According to the sources, real estate prices rose by 15% in 2010, and 85% of Chinese families are unable to buy a house.

China's priority in 2011 seems to aim at stabilizing the exchange rate for the yuan, not only against the dollar but also against the currencies of other major powers such as the euro and the yen. It is therefore unlikely for authorities to decide a great appreciation for the yuan next year.

Roubini believes that the "star" of 2011 will be India<sup>30</sup> with an economic growth of 8.8% compared to 9% in 2010, while China will slow their progress a little at 8.7 percent, from 10% as a result of administrative measures to prevent economy overheating.

The major challenge for emerging markets will be to face a wave of inflation that is to hit the world in 2011, amid massive printing of currency in the U.S. and EU.

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<sup>29</sup> [www.roubini.com/region/country/china.php](http://www.roubini.com/region/country/china.php)

<sup>30</sup> [www.roubini.com/analysis/140742.php](http://www.roubini.com/analysis/140742.php)

### 3. Conclusion

With some countries preparing bond issues and exposing them to the test of the markets, the next few weeks will be decisive for the future of the euro. As the European press clarifies, we'll shortly have a clear amount of market sureness in the ability of the most delicate countries of the Eurozone to put their finances in order, as well as on the future stability of the single currency.

And if the euro overcomes the existing crisis, its success will be in part claimed by the Far East economies. Japan and China probably will invest in forthcoming European bond issues. Beijing and Tokyo are engaged in a war of influence both in Asia and in the rest of the world. And this is the circumstance of the Chinese Vice-Premier's triumphal visit to Madrid to announce the decision to buy Spanish sovereign bonds, which recently took place. At the same time, Japan has announced it will buy 20% of the bonds issued by the European Financial Stability Facility.<sup>31</sup>

This bizarre help coming from Asia is based on a reason, which is the least revealed but probably the most important and that is Asia does not want the Euro to collapse. The Chinese are well aware that the 27-country EU trade bloc ranks ahead of the United States as their main market, while the Japanese are preoccupied by the risk of a new „endaka”<sup>32</sup> that will negatively affect their exports.

The first month of the year 2011 will remain in history on account of the European Commission who will give its final approval to the EU strategy for smart, sustainable and inclusive growth, which is the first step towards the harmonization of member-state budgets and effective economic government of the EU. So, almost certainly, 2011 will be the year to lay the foundation of a strong future Euro, or the beginning of a new Europe without Euro.

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<sup>31</sup> <http://www.elpais.com/global/>

<sup>32</sup> <http://www.x-rates.com/d/JPY/USD/graph120.html>



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